

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

NOTE 3 - DEPOSITS WITH FINANCIAL INSTITUTIONS, INVESTMENTS, AND REVERSE REPURCHASE AGREEMENTS

Deposits

The County maintains deposit relationships with several local commercial banks and savings and loan banks in addition to its concentration bank.

All deposits not covered by the Federal Depository Insurance Corporation (FDIC) are covered by the Public Deposit Protection Commission of the State of Washington (PDPC). The PDPC is a statutory authority established under the *Revised Code of Washington (RCW)*, Chapter 39.58. It constitutes a multiple financial institution collateral pool that can make *pro rata* assessments to all public depositories within the state of up to 10 percent of all their public deposits. There is no current provision for PDPC to make additional *pro rata* assessments if needed to cover a loss. Therefore, PDPC protection is of the nature of collateral, not of insurance, in accordance with Governmental Accounting Standards Board (GASB), *Codification of Governmental Accounting and Financial Reporting Standards*, Section I50.110. As of December 31, 2001, the carrying amount of deposits for the Primary Government was \$292,657,458 and the bank balance was \$298,696,068.

	CARRYING AMOUNT	BANK BALANCE	CATEGORY 1	CATEGORY 2	CATEGORY 3
Demand deposits	\$ 32,462,446	\$ 38,501,056	\$ 35,916,946	\$	\$ 2,584,110
Certificates of deposit	260,195,012	260,195,012	176,034,119		84,160,893
Total deposits	<u>\$ 292,657,458</u>	<u>\$ 298,696,068</u>	<u>\$ 211,951,065</u>	<u>\$ -0-</u>	<u>\$ 86,745,003</u>

Category 1 includes (1) deposits insured by the FDIC; and, (2) a proportionate share of deposits uninsured but collateralized under the PDPC multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the County's agent in the name of the County. Some large depositories held public deposits in amounts in excess of the market value of the entire PDPC collateral pool. To the extent that uninsured public deposits of a financial institution exceed the PDPC's total pool value, equivalent proportions of the County's deposits in those institutions are classified as Category 3. Determination of these amounts is based on the conservative assumption that none of the excess public deposits were covered by FDIC insurance. Although such risk is recognized, the PDPC provides additional protection by maintaining strict standards as to the amount of public deposits financial institutions can accept, and by monitoring the financial condition of all public depositories and optimizing collateralization requirements. There are no uninsured deposits which are collateralized by securities held by the County's agent but not in the County's name (Category 2).

Investments

Statutes authorize King County to invest in obligations of the United States Treasury and instrumentalities; banker's acceptances issued in the secondary market; commercial paper; primary certificates of deposit issued by Washington State qualified public depositories as defined under *RCW* 39.58; and the State Treasurer's Investment Pool. The County is also authorized to enter into repurchase and reverse repurchase agreements.

County investment policies require that securities underlying repurchase agreements must have a market value of at least 102 percent of the cost of the repurchase agreement for investment terms of less than 30 days, and 105 percent for terms longer than 30 days. Repurchase agreements in excess of 60 days, and reverse repurchase agreements exceeding 180 days, are

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not allowed. Currently, the County's tri-party custodial bank monitors compliance with these provisions. The County does not enter into yield maintenance repurchase agreements. The County operates under the GASB's *Codification*, Section 2300.601, definition of derivatives and similar transactions. During the year, the County did not buy, sell, or hold any derivative or similar instrument except for certain mortgage-backed securities purchased by the King County investment pool to enhance investment yield. Although these securities are sensitive to early prepayments by mortgagees, usually resulting from a decline in interest rates, County policies are in place to ensure that only the lowest risk securities of this type are acquired.

The County's investments are categorized to give an indication of the level of credit risk assumed at year-end. Category 1 includes investments that are insured or registered, or for which the securities are held by the County or its agent in the County's name.

	CATEGORY 1	CATEGORY 2 & 3	CARRYING AMOUNT (FAIR VALUE)
Repurchase agreements	\$ 357,914,649	\$	\$ 357,914,649
Commercial paper	428,674,095		428,674,095
Municipal bonds	151,142,213		151,142,213
U. S. government securities:			
Mortgage-backed securities	318,117,120		318,117,120
Treasury notes	163,365,196		163,365,196
U. S. agency issues	1,712,767,602		1,712,767,602
Totals	<u>\$ 3,131,980,875</u>	<u>\$ -0-</u>	<u>3,131,980,875</u>
State Treasurer's Investment Pool			258,075,233
Investments under reverse repurchase agreements			46,732,687
Total Investments (Primary Government)			<u>\$ 3,436,788,795</u>

The above schedule shows the types of investments made during the year, and the investment values at the end of the year for the Primary Government. These exclude the equity in the component units, i.e., Harborview Medical Center and the Washington State Major League Baseball Stadium Public Facilities District. To comply with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all investments are reported at fair value. Fair value pricing is provided by the County's safekeeping bank or an independent pricing source.

There were no losses incurred during the period as a result of default by counterparties to deposit or investment transactions. During the period, there were no known violations of legal or contractual provisions for deposits and investments.

Reverse Repurchase Agreements

Statutes permit King County to enter into reverse repurchase agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. County policy prohibits the use of these agreements as a borrowing mechanism. The proceeds from these agreements are reinvested in other instruments with the same maturities as the collateral securities, resulting in a matched position.

In accordance with the GASB's *Codification*, Section I55.116-117, the assets and liabilities related to the investment pool owned reverse repurchase agreements were allocated to the individual pool participants based on their equity in the pool as of December 31, 2001. The liability is

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reported as obligations under reverse repurchase agreements and the assets are reflected as an increase in cash equivalents in the balance sheets of funds that participate in the internal portion of the investment pool and in the balance sheet of the Investment Trust Fund for funds that participate in the external portion of the Investment Pool.

Reverse repurchase agreements are subject to credit risk. Should the dealers default on their obligation to resell these securities to the County, the County would be faced with an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. The credit exposure at year-end was \$769,000 on reverse repurchase agreements in the Investment Pool.

External Investment Pool

For investment purposes, the County pools the cash balances of County funds and component units and also allows for participation by other legally separate entities such as special districts, for which the County is *ex officio* treasurer, and public authorities. The King County Investment Pool (the Pool) is an external investment pool in accordance with GASB 31, *Accounting and Financial Reporting For Certain Investments and for External Investment Pools*. The external portion of the Pool (portion that belongs to special districts and public authorities other than component units) is reported in an Investment Trust Fund. Certain of the County's debt service and reserve funds are restricted to investments permitted under the authorizing ordinances and resolutions, and therefore are not invested in the Pool. It is County policy to invest all other County funds in the Pool. All non-County participation in the Pool is voluntary.

The Pool is not registered with the SEC as an investment company. Oversight is provided by the King County Executive Finance Committee (EFC) pursuant to RCW 36.29.020. The EFC consists of the Chair of the County Council, the County Executive, the Chief Budget Officer, and Manager of the Finance and Business Operations Division. All investments are subject to written policies and procedures adopted by the EFC. The EFC reviews pool performance monthly.

Summary information for all pool investments are presented below:

Investment	Fair Value	Principal	Average Interest Rate	Average Years to Maturity
Certificates of Deposit	\$ 60,000,000	\$ 60,000,000	3.20	0.70
Repurchase Agreements	103,265,000	103,265,000	1.92	0.01
Commercial Paper	430,174,093	431,154,000	2.32	0.13
Municipal Bonds	161,349,405	158,550,000	5.90	1.17
U.S. Government Securities:				
Treasury Securities	49,890,000	50,000,000	2.47	1.83
Agency Securities	975,493,801	952,960,000	5.47	1.81
Agency Mortgage-Backed Securities	416,008,149	409,173,183	6.11	2.71
State Treasurer's Investment Pool	275,504,006	275,504,006	2.31	0.15
Total	<u>\$ 2,471,684,454</u>	<u>\$ 2,440,606,189</u>	4.43	1.33

The Pool values participants' shares using an amortized cost basis. Monthly income is distributed to participants based on their relative participation during the period. Income is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) reduced by the contractually agreed upon investment fee. This method differs from the fair value method used to value investments in this

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statement because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values. The total difference between fair values of the investments in the Pool and the values distributed to the Pool participants using the amortized cost method described above is reported in the equity section of the statement of net assets as undistributed and unrealized gains.

All securities are reported at fair value. Fair value reports are prepared monthly and are distributed to all Pool participants. Fair value pricing is provided by the County's security safekeeping bank. If a security is not priced by the County's safekeeping bank, prices are obtained from Bloomberg L.P., a provider of fixed income analytics, market monitors, and security pricing. The County has not provided or obtained any legally binding guarantees to support the value of the Investment Pool's shares.

Custodial Risk

The Pool's deposits and investments are classified in various categories of custodial risk based on the same criteria for all deposits and investments of the County.

Demand deposits consist of \$60 million in certificates of deposits (CD), of which \$38,830,458 are category 1 and \$21,169,542 are category 3.

Investments other than CDs are categorized into risk categories as follows:

	CATEGORY 1	CATEGORY 2 & 3	CARRYING AMOUNT (FAIR VALUE)
Repurchase agreements	\$ 103,265,000	\$	\$ 103,265,000
Commercial paper	430,174,093		430,174,093
Municipal bonds	161,349,405		161,349,405
U. S. government securities:			
Mortgage-backed securities	338,546,044		338,546,044
U. S. agency issues	1,053,072,572		1,053,072,572
Totals	<u>\$ 2,086,407,114</u>	<u>\$ -0-</u>	<u>2,086,407,114</u>
State Treasurer's Investment Pool			275,504,006
Investments under reverse repurchase agreements			49,908,992
Total Investments (Total Pool)			<u><u>\$ 2,411,820,112</u></u>

The County's voluntary investment in the Washington State Treasurer's Local Government Investment Pool (LGIP) is not categorized because it is not evidenced by securities in physical or book entry form. The amount is carried at cost which approximates fair value. The LGIP is a 2a7-like pool that is overseen by the Office of the State Treasurer, the State Finance Committee, the Local Government Investment Pool Advisory Committee, and the Washington State Auditor's Office. The LGIP also contracts for an annual outside independent audit.

As previously indicated, the Pool owns reverse repurchase agreements at December 31, 2001. The investments under reverse repurchase agreements in the above schedule represent the collateral securities transferred to the lender in exchange for the cash received and used to purchase other securities. These securities are also not categorized because they are held by the lender as collateral.

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The following is a condensed statement of net assets and changes in net assets for the entire King County Investment Pool as of December 31, 2001:

Condensed Statement of Net Assets	
Assets	\$ 2,481,566,258
Less: Liabilities	(55,149,250)
Net assets held in trust for pool participants	<u>\$ 2,426,417,008</u>
Equity of internal pool participants	\$ 1,364,426,578
Equity of external pool participants	1,061,990,430
Total equity	<u>\$ 2,426,417,008</u>
Condensed Statement of Changes in Net Assets	
Net assets at Dec. 31, 2000	\$ 2,052,534,795
Net change in investments by pool participants	373,882,213
Net assets at Dec. 31, 2001	<u>\$ 2,426,417,008</u>

Individual Investment Accounts

King County also sponsors individual investment accounts for other legally separate entities, such as special districts and public authorities that are not part of the financial reporting entity. Net assets in these individual investment accounts are reported in a separate Investment Trust Fund in the Trust and Agency section.

Component Units**Harborview Medical Center**

Harborview Medical Center (HMC) participates in the County's investment pool. HMC's equity in the pool (reported as cash equivalents at June 30, 2001) amounted to \$126,717,922. In addition, HMC maintains demand deposit accounts in various banks. Demand deposits (insured up to \$100,000) total \$1,774,301 with a carrying amount of \$1,661,550. HMC also has access to \$1,640,506 in a University of Washington account for capital projects. Deposits and investments for the HMC component unit are categorized according to levels of custodial risk using the same criteria as the categorization for the King County Investment Pool deposits and investments:

	Carrying <u>Amount</u>	Bank <u>Balance</u>	Category <u>1</u>	Category <u>2</u>	Category <u>3</u>
Equity in Investment Pool	\$126,717,922	\$126,717,922	\$124,599,198		\$ 2,118,724
Cash in other banks	1,661,550	1,774,301	388,962		1,385,339
Total	<u>\$128,379,472</u>	<u>\$128,492,223</u>	<u>\$124,988,150</u>	<u>-0-</u>	<u>\$ 3,504,063</u>

Washington State Major League Baseball Stadium Public Facilities District

The Washington State Major League Baseball Stadium Public Facilities District (PFD) participates in the County's investment pool. The PFD's equity in the pool (reported as cash equivalents at December 31, 2001) amounted to \$16,198,100. Deposits and investments for the PFD component unit are categorized according to levels of custodial risk using the same criteria as the categorization for the King County investment pool. Of the PFD's equity in the investment pool, \$15,927,268 is classified as Category 1 and \$270,832 is Category 3.